

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0387

For The Period: 1994 Through 1996

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ISSUES

I. Tax Administration: Payment Application

Authority: IC 6-8.1-8-1.5; 45 IAC 15-8-1

The taxpayer protests the Department's method of "allocating a taxpayer's payment to its tax liability, penalty and interest."

STATEMENT OF FACTS

Taxpayer is a general contractor that installs doors, windows, and gutters. After the taxpayer was audited, the taxpayer made a payment to the Department of Revenue. As will be elaborated below, the taxpayer's protest turns on whether the taxpayer's payment was a "full" payment or a "partial" payment.

I. Tax Administration: Payment Application

DISCUSSION

The taxpayer offers a timeline for the events and issues in the protest. In bullet point, here are the pertinent dates:

- May 1, 1998: The Department of Revenue issues the tax bill for the audit period (AR-80);
- June 25, 1998: Taxpayer files a protest with the Department of Revenue (received by the Department on June 29, 1998);
- July 13, 1998: Department sends out a letter acknowledging that it has received the taxpayer's protest. The letter from the Department contains the following paragraph: "Please be aware that interest will continue to accrue on the assessment until a final disposition of the case is made. In order to avoid the additional interest accrual, a

payment in full may be made with the option of requesting a refund for any assessed items not found to be subject to the tax.”

- February 4, 2000: Taxpayer sends the Department a letter dated 2/4/00 along with a check in the amount of \$25,787.23. The taxpayer states in the letter accompanying the check: “Subtracting [the amount the taxpayer disputed/protested, namely \$1,260.22] from the \$27,047.45 [the *principal* tax owed] results in an amount of \$25,787.23. A check for that amount is enclosed for your processing which should conclude this matter.”

In October of 2000, the Department did a “supplemental audit” which adjusted the taxpayer’s principal amount owed from \$27,047.45 to \$26,169.39.

The Department contends that the payment was a partial payment since it did not cover the full amount owed (*viz.*, penalty, interest, and principal tax liability). Indiana Code 6-8.1-8-1.5 deals with partial payment of tax:

Whenever a taxpayer makes a partial payment on the taxpayer’s tax liability, the department shall apply the partial payment in the following order:

- (1) To any penalty owed by the taxpayer.
- (2) To any interest owed by the taxpayer.
- (3) To the tax liability of the taxpayer.

The taxpayer says of the above statute,

[A] **partial payment** on the taxpayer’s tax liability will be applied by the department first to penalties, second to interest and third to the tax liability of the taxpayer. ... When we made the \$25,787.23 payment it was a FULL not a partial payment on the taxpayer’s tax liability. The penalty and interest amounts were not paid at that time pending the outcome of the protest. The law itself distinguishes between the tax liability and the interest and penalties associated with a taxpayer’s tax liability. (Emphasis in the original)

It is somewhat difficult to understand what the taxpayer could mean by stating “it was a full not a partial payment on the taxpayer’s tax liability”—the taxpayer did not issue a check for over a 1½ years after the billing; the taxpayer on its own subtracted out what it did not think it owed from the principal liability, and the taxpayer did not pay the penalty and interest. Yet the taxpayer concludes it paid the “full” amount.

Part of the problem might be confusion over what the term “tax liability” means. The statute, uses the term twice—

Whenever a taxpayer makes a partial payment on the taxpayer’s *tax liability*, the department shall apply the partial payment in the following order:

- (3) To the *tax liability* of the taxpayer. (Emphasis added)

But the Indiana Administrative Code (45 IAC 15-8-1) clarifies and distinguishes the two meanings of tax liability:

- (a) If a taxpayer makes a partial payment of the taxpayer's *tax liability*, the payment shall only be applied first against the penalty, second the interest and third the *principal liability* of the particular billing for a given year and tax. (Emphasis added)

Thus when IC 6-8.1-8-1.5 (3) refers to "tax liability" it means the *principal* tax liability. Taxpayer apparently realizes as much, stating in a letter that "Regulation 45 IAC 15-8-1 basically echoes the law but for the third item of payment designation uses the phrase 'principal liability for income tax.'"

The taxpayer also argues that the letter dated July 13, 1998 from the Department acknowledging receipt of the taxpayer's written protest gave it the impression that it did not have to pay the penalty and interest since the matter was under protest. Here is the paragraph at issue:

Please be aware that interest will continue to accrue on the assessment until a final disposition of the case is made. In order to avoid the additional interest accrual, a payment in full may be made with the option of requesting a refund for any assessed items not found to be subject to the tax.

The paragraph is clear—any confusion in the meaning lies with the taxpayer's desire to read "full" as meaning what it thinks it owes on the principal liability.

To summarize: the Department received a payment from the taxpayer. In line with the statute and the regulation requirements, the Department applied the payment first to the penalty, then to the interest, and lastly to principal tax liability. The taxpayer wants to "direct the application" of the payment it made to the principal liability and call it a "full payment." However the law does not allow the taxpayer to earmark the payment—instead, by statute the order is: penalty, interest, and principal liability.

FINDING

The taxpayer's protest is denied.